No. 12796

United States Court of Appeals

FOR THE NINTH CIRCUIT

BORK MANUFACTURING CO., INC., a Corporation and ALVIN BORKIN, an Individual and President of Bork Manufacturing Co., Inc.,

Petitioners,

vs.

FEDERAL TRADE COMMISSION,

Respondent.

Reply Brief and Argument for Petitioners

PETITION TO REVIEW AN ORDER OF
THE FEDERAL TRADE COMMISSION

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I.

THE ORDER OF THE COMMISSION IS TOO BROAD IN THAT IT RESTRAINS THE RESPONDENTS FROM SHIPPING THEIR MERCHANDISE TO PERSONS WHO ARE ENGAGED IN INTRASTATE COMMERCE AND ARE THEREFORE OUTSIDE THE ACTIVITIES WHICH THE COMMISSION IS EMPOWERED TO POLICE.

At the outset we should like to impress upon the court that our customers fall into two groups. These two groups are discussed in the Commission's brief at Pages 34 and 35 in the Bork brief. One group consists of dealers in interstate commerce. The other group consists of local dealers who sell merchandise only in intrastate commerce. The commission,

in its brief on the pages just referred to, distinguishes between these two groups, but argues that sales by us to both groups may be restrained. As to the group which consists of dealers in interstate commerce, grant for the sake of argument that the Commission has the right to restrain us from shipping our push cards and punch boards to them. As to the local dealers who sell merchandise only in intrastate commerce, we emphatically deny the power of the Commission to restrain our shipments of punch boards and push cards and we submit that the Commission is completely in error on this score because by its own theory, it claims the right to restrain us because we are alleged to "place in the hands of (our) customers and supply (our) customers with a means of violating the Federal Trade Commission Act." The *Bunte Brothers* case clearly holds that our customers who sell merchandise only in intrastate commerce are not violating the Federal Trade Commission Act. Since the theory of the Commission with respect to shipment to dealers who sell merchandise only in intrastate commerce is in direct conflict with the *Bunte Brothers* case, it necessarily follows that the order of the Commission in so far as it restrains us from shipping to customers who sell merchandise only in intrastate commerce is erroneous and the order should be at least restricted to restraining us from shipping only to dealers engaged in interstate commerce.

The following suggested order would be in conformity with the holding in the *Bunte Brothers* case:

> "* * * do forthwith cease and desist from:
>
> "Selling or distributing in commerce, as 'commerce' is defined in the Federal Trade Commission Act, punch boards, push cards, or other lottery devices to persons, firms and corporations who will pack and assemble assortments comprised of various articles of

> merchandise together with said push cards and punch board devices for shipment of said assortments in interstate commerce."

The brief for the Commission does a remarkable job of confusing the issues and in carefully avoiding an exposition of the precise bases upon which the Commission seeks an extension of its powers. The breadth of the order entered by the Commission is an unquestioned attempt to extend the powers of the Commission by seeking to exercise control over intrastate activities. The basic issue in this case is of utmost simplicity and the determination of that issue is definitely and emphatically controlled by the decision of the Supreme Court in *Federal Trade Commission v. Bunte Brothers,* 312 U. S. 351.

In the *Bunte Brothers* case, the Commission, as in the instant case, sought to broaden its powers by attempting to exercise jurisdiction and control over intrastate transactions. The Supreme Court blocked this attempted extension of power by the Commission.

Bunte Brothers was engaged in a method of merchandising candy which would clearly have been restrainable by the Federal Trade Commission if Bunte Brothers had been engaged in interstate commerce, and in fact, the company had already been restrained from using those practices in so far as it was engaged in interstate commerce. (*Bunte Brothers v. Federal Trade Commission,* 104 F. 2d 996).

In denying the power of the Commission to restrain Bunte Brothers in so far as it was engaged in intrastate commerce, the Supreme Court said (Page 351):

> "That for a quarter century the Commission has made no such claim is a powerful indication that effective enforcement of the Trade Commission Act is not dependent on control over intrastate transactions."

The court further said (Page 354):

> "The construction of §5, 15 U.S.C.A. §45, urged by the Commission would thus give a Federal agency pervasive control over myriads of local businesses in matters heretofore traditionally left to local custom or local law. Such control bears no resemblance to the strictly confined authority growing out of railroad rate discrimination. An inroad upon local conditions and local standards of such far-reaching import as is involved here, ought to await a clearer mandate from Congress."

The Commission is apparently not content to await a clear mandate from Congress, but in the instant matter, is seeking to extend its power in order to exercise control over local businesses in matters heretofore traditionally left to local custom or local law and seeks to regulate local conditions and local standards.

According to the decision in the *Bunte* case, the Commission has absolutely no power to restrain the merchandising of commodities with the use of punch boards and push cards, as long as such merchandising is in intrastate commerce. Yet the Commission has arrogated to itself the power to restrict our shipment of instrumentalities to customers who have a perfect right to use them without any interference by the Commission. The foundation upon which the Commission seeks to exercise this power is not made clear in its brief. As nearly as we can laboriously extract from the brief of the Commission, the basis for this claimed power is supposed to rest upon the power of the Commission to police the morals of the public and to restrain accessories to persons who are engaged in lottery merchandising. Neither of these grounds furnishes a basis for the Commission's claimed power because with respect to both of these bases, the Commission overlooks the element of interstate commerce.

It should be observed that the Commission cannot, as such, police the morals of the public. It is limited to operating upon "traders * * * who may * * * by pursuing a dishonest practice, force his competitors to chose between its adoption or the loss of their trade. * * * It is true that the statute does not authorize regulation which has no purpose other than that of relieving merchants from troublesome competition or of censoring the morals of businessmen." (*Federal Trade Commission v. Keppel & Bro.*, 291 U.S. 311, 313). But even in such situations where the Commission is empowered to act because of competitive practices which are deemed contrary to public policy, those competitive practices must be present in interstate transactions. This is the clear holding in the *Bunte Brothers* case which still stands as the last exposition of the law in this respect by the Supreme Court of the United States.

With respect to the other ground upon which the Commission purports to support its claim of power, namely, that it can restrain persons who contribute to activities which the Commission can restrain, again the Commission overlooks the element of interstate commerce. Those of the respondents' customers who use the punch boards and push cards of the respondents in intrastate commerce, are free to do so without any interference by the Commission. So far as the Federal Trade Commission Act is concerned, and so far as the Federal Trade Commission is concerned, those customers are not engaged in any activities condemned by the Federal Trade Commission Act. In order that the petitioners may be subjected to restraint, it is necessary to demonstrate that they are aiding and abetting persons who are violating the Federal Trade Commission Act. As to customers of the respondents who are engaged in intrastate commerce, this essential element is completely absent because those customers are not violating the Federal Trade Commission Act. *In short, the Commission seeks, in this case, to restrain the respondents from contributing to an activity which, so far as the Federal Trade Commission Act and the Federal Trade*

Commission is concerned, is perfectly lawful or at least not subject to interference by the Commission by virtue of the decision of the Supreme Court in the Bunte Brothers case.

This court in *California Rice Industry v. Federal Trade Commission,* 102 F. 2d 716, in a decision which antedated the decision by the Supreme Court in the *Bunte Brothers* case, denied the power of the Federal Trade Commission over intrastate aspects of alleged monopolies in restraint of trade. This decision by this court which finds complete confirmation by the Supreme Court in the *Bunte Brothers* case, may be sharply contrasted with the decision in *Charles A. Brewer and Sons v. Federal Trade Commission,* 158 F. 2d 74, where the court failed to recognize the essential element of interstate activity as the basis for competent Commission restraint. It is true that the court in the *Brewer* case attempts to distinguish the *Bunte Brothers* case, but we submit that the attempted distinction is not sufficiently precise in that there is no differentiation made by the court with respect to two different classes of customers, namely, those who are engaged in interstate merchandising and those who are engaged in intrastate merchandising. The principle upon which the Brewer decision rests itself destroys the supposed distinction between the situation existing in the *Brewer* case and that existing in the *Bunte Brothers* case. The court in the *Brewer* case rested its decision upon the principle "that a person is a wrongdoer who so furnishes another with the means of consummating a fraud has long been a part of the law of unfair competition."

More specifically stated with respect to the field in which this case arises, the court held (Page 77):

> "For the reasons hereinafter appearing, we have reached the conclusion that, in thus aiding and abetting, inducing and procuring manufacturers and wholesale and retail dealers in merchandise to use unfair or deceptive acts or practices and unfair methods of

competition, Charles A. Brewer & Son, though manufacturing no merchandise except the lottery device which they had shipped in interstate commerce, fall within the restraining power of the Federal Trade Commission as vested by the Federal Trade Commission Act."

The foregoing is a rather unfortunate expression of the conclusion of the court because it lumps together all of the customers of Charles A. Brewer & Son without distinguishing between those who use the lottery devices in interstate activities and those who use them in intrastate activities. The first group is, of course, composed of violators of the Federal Trade Commission Act. The second group is not subject to the interdiction of the Federal Trade Commission Act. Brewer & Son were using no unfair or deceptive acts or practices or unfair method of competition. The only basis upon which the court justified restraining shipments by Brewer & Son was that Brewer & Son were supposed to be aiding and abetting others to use unfair or deceptive acts or practices. Yet it has been held in the *Bunte* case that intrastate merchandising by lottery is not using unfair or deceptive acts or practices. How then can the decision in the *Brewer* case be justified in so far as it sustains the restraint upon shipment to customers engaged only in intrastate merchandising? Such conclusion is in direct conflict with the decision in the *Bunte Brothers* case and in the *California Rice Industry* case. Even granting *arguendo* that the principle enunciated in the *Brewer* case, that aiding and abetting an act violative of the Federal Trade Commission Act justifies restraint of the aider or abetter, the conclusion reached by the court is thoroughly unjustified because of the complete absence of the primary act violative of the Federal Trade Commission Act, in the case where customers are engaged in intrastate commerce. As to those customers the situation might be regarded as analogous to charging one with being

an accessory to a crime when, in fact, no crime had ever been committed.

We submit the possibility that the court in the Brewer decision in reaching its broad and indiscriminate conclusion, was led astray by the unfortunate reasoning in *Modernistic Candies v. Federal Trade Commission,* 145 F. 2d 454, 455. A quotation from the last cited case appears at Page 78 of the Brewer decision.

In the *Modernistic Candies* case, the court said:

> "It is clear that the Federal Trade Commission has the power to arrogate merchandise by gambling in interstate commerce."

This is an accurate statement of the law because it includes the vital element that the merchandising be in interstate commerce. The court however, continues:

> "We think the Commission also has the power to prohibit the distribution in interstate commerce of devices intended to aid and encourage merchandising by gambling. The gamblers and those who deliberately and designedly aid and abet them are both engaged in practices contrary to public policy."

Here the court again states the law too broadly because it fails to include the element of interstate commerce. Merchandising by gambling is cognizable by the Federal Trade Commission only when it is present in interstate commerce. If it is present in intrastate commerce, the *Bunte Brothers* case holds it is not restrainable by the Federal Trade Commission. Therefore only those who aid and abet merchandisers by gambling in interstate commerce can possibly fall within the restraints of the Federal Trade Commission Act. The confusion of the court in the *Modernistic Candies* case is further demonstrated by their statement, "if the Federal

Trade Commission is to police merchandising by gambling, it must police those who designedly aid and abet this practice." The Supreme Court in the *Bunte Brothers* case has squarely held that it is not the function of the Federal Trade Commission to police merchandising by gambling where the merchandiser is engaged in intrastate commerce. Again, the Circuit Court of Appeals in the *Modernistic Candies* case has overlooked the essential element of intrastate commerce and has given expression to a too comprehensive scope and character of the policing function of the Federal Trade Commission.

Our position finds confirmation in the complaint filed in the instant case. Apparently, the Commission initially had a more accurate conception of the elements which had to be present in order to restrain the petitioners. In paragraph 1 of the complaint (Tr. 4) it was alleged:

> "Respondents are now and for more than three years last past have been engaged in the manufacture of devices commonly known as push cards and punch boards, and in the sale and distribution of said devices to manufacturers of and dealers in various articles of merchandise *in commerce between and among the various states of the United States, and in the District of Columbia.*" (Italics ours.)

It is apparent that the Commission felt, and properly so, that it was necessary to allege that the customers of the respondents were engaged in interstate commerce. In paragraph 3 of the complaint (Tr. 6) the Commission in the same vein, becomes more specific and alleges:

> "Many persons, firms and corporations who sell and distribute, and have sold and distributed, candy, cigarettes, clocks, razors, cosmetics, clothing and other articles of merchandise *in commerce between and among the various States of the United States and in*

> *the District of Columbia,* purchase and have purchased petitioners' said push card and punch board devices * * *." (Italics ours.)

The concluding allegation of paragraph 4 is most enlightening as to the Commission's conception of the essential element of the charge (Tr. 7):

> "The respondents thus supply to, and place in the hands of, said persons, firms and corporations the means of, and instrumentalities for, engaging (in) unfair acts and practices within the intent and meaning of the Federal Trade Commission Act."

Under the *Bunte Brothers* case and the *California Rice Industry* case, the only persons, firms and corporations who could be guilty of unfair acts and practices within the intent and meaning of the Federal Trade Commission Act, would be those who are engaged in merchandising in interstate commerce, and accordingly, the charge in the complaint accurately and precisely levels the only plausible criticism against the respondents who are charged with supplying the devices to persons, firms and corporations who are engaging in unfair acts and practices within the intent and meaning of the Federal Trade Commission Act. *But the order entered by the Commission goes beyond this charge and restrains the supplying of the device to all customers and not merely those who are violating the Federal Trade Commission Act.* Apparently, during the course of the proceeding, the Commission acquired an exaggerated concept of its power and gave itself relief greater than that sought in its own complaint. Aside from the substantial significance of the variance between the complaint and order, as a procedure matter the variance invalidates the order. See *Federal Trade Commission v. Goatz,* 253 U.S. 421, where the court said at page 427:

> "Such an order shall follow the complaint; otherwise it is improvident, and, when challenged, will be annulled by the court."

We do not propose to answer the Commission's brief *seriatim*. We believe it will be sufficient to point out that the theory of the Commission is fundamentally fallacious because it fails to embrace the criterion of interstate character of the merchandising by lottery. This is clearly indicated by the Commission's brief at Page 10 in which they formulate their conception of the two basic fundamental principles which undoubtedly are the principles upon which the Commission rests its entire case. The first principle, as stated by the Commission, is:

> "The sale of goods by a plan or method which involves the use of a game of chance, gift enterprise, or lottery is a practice which is contrary to an established policy of the Government of the United States and is an unfair method of competition and an unfair act and practice in violation of the Federal Trade Commission Act."

It is impossible to frame a clearer contradiction of the holding in the *Bunte Brothers* case. The failure to include the element of interstate character renders this supposed principle hopelessly deficient. Yet, the order of the Commission necessarily rests upon the principle exactly as formulated on Page 10 of the Commission's brief. Both the principle as stated and the order of the Commission fail to take into account that the *Bunte Brothers* decision renders the Commission powerless to interfere with merchandising by lottery in intrastate commerce.

The second principle upon which the Commission rests its order is thus stated at Page 10 of the Commission's brief:

> "Supplying to or placing in the hands of others the means or methods of conducting a game of chance,

> gift enterprise, or lottery in the sale and distribution of merchandise is an unfair method of competition and an unfair act and practice in violation of the Federal Trade Commission Act."

This statement not only begs the question in the case, but is also inaccurate for exactly the same reasons which invalidate the first principle hereinabove discussed at length.

Throughout the brief of the Commission we find a repitition of the error which crept into the initial statement of fundamental principles by the Commission, namely, the nonchalant discard of the one element regarded as vital by the Supreme Court in the *Bunte Brothers* case—the element of interstate commerce.

Throughout the Commission's brief the hobgoblins of gambling and public policy are raised in an effort to frighten this court into sustaining the Commission's order. The fate of the morals of the whole nation supposedly hinges on the action of this court. The Commission paints itself as a crusader devoted to the specific task of eradicating the use of punch boards and push cards throughout the United States thereby rescuing the American public from this evil. The short answer to this emotional appeal to the court's understandable prejudice against gambling is that the Supreme Court of the United States in the *Bunte Brothers* case has squarely held that the Commission can legitimately operate only within the limited sphere of influence circumscribed by the Federal Trade Commission Act. The Supreme Court has held that merchandising by lottery in intrastate commerce does not fall within the sphere of influence of the Federal Trade Commission. Any broadening of this sphere must be by Congress and not by the Commission.

The action of Congress in connection with gambling activities is most significant, but that significance is distorted by the Commission in its brief. (*Bork* Brief, particularly at Pages 45 to 48). In the legislation discussed by the Com-

mission, Congress has followed the recommendation of the Supreme Court and has specifically excluded certain gambling devices, namely, slot machines, from interstate traffic. Significantly enough, Congress has not seen fit to include a specific prohibition against shipping push cards and punch boards within the prohibition. Fundamental logic compels the conclusion that where Congress specially legislates with respect to certain gambling devices and fails to legislate against punch boards and push cards, it is obviously the legislative intent not to cover the latter. While it is true that the report of the House Committee on Interstate and Foreign Commerce refers to the use of lotteries, games of chance, or other gambling devices for the purpose of merchandising as an unfair trade practice, that reference must be construed in the light of the decision in the *Bunte* case and we must necessarily refer to the use of lotteries, etc. for the purpose of merchandising in interstate commerce. The use of lotteries for the purpose of merchandising in intrastate commerce has been held by the Supreme Court not to violate the Federal Trade Commission Act. Knowing that, Congress has still not seen fit to prohibit the shipment of punch boards and push cards in interstate commerce. Congress is still content to leave in effect the powers of the Federal Trade Commission as defined in the *Bunte* case. That is to say, the powers of the Federal Trade Commission are still confined to merchandising by lottery in interstate commerce and the Commission possesses no power over merchandising by lottery in intrastate commerce. By the same token that the United States public policy permits shipments of slot machines to any state which has enacted a law exempting that state from the provisions of the Slot Machine Act, the public policy of the United States, if that has any bearing on the case, should be regarded as permitting the shipment of push cards and punch boards to any customer for use in a manner not violative of the Federal Trade Commission Act.

II.

THE ENTIRE ORDER OF THE COMMISSION IS IMPROPER BECAUSE IT DOES NOT RESTRAIN THE RESPONDENTS FROM USING ANY UNFAIR METHOD OR PRACTICE RELATING TO COMPETITIVE ACTIVITIES BUT BROADLY RESTRAINS THE SHIPMENT OF MERCHANDISE AS SUCH.

At times peculiar circumstances of cases and extensive litigation in a field of law resulting in decisions wherein courts adopt unfortunate expressions of prior decisions, results in a clouding of fundamental concepts formulated by the legislature. We submit that this situation has developed in the field of law arising under the Federal Trade Commission Act. We submit that the time has come for the courts to revert to first principles. These first principles are contained in the Federal Trade Commission Act which declares:

> "Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce are hereby declared unlawful."

The act further provides (Section 5):

> "The Commission is hereby empowered and directed to prevent persons, partnerships, or corporations, * * * from *using* unfair methods of competition in commerce and unfair or deceptive acts or practices in commerce." (Italics ours.)

It should be observed that the power of the Commission is directed to prevent persons from *using* certain condemned methods and acts or practices. As a matter of fundamental common sense, the person charged with violating the act must be guilty of using a method or act or practice which is unfair. The sale of any commodity as a sale can never be restrained. It is only the sale accompanied by the use of an unfair method or practice which is condemned by the Act.

The court in *Scientific Manufacturing Co. v. Federal Trade Commission,* 124 F. 2d 640, did not allow itself to be diverted from first principles. In that case the Commission restrained the publication and sale of pamphlets which the Commission found were false, misleading and disparaging of utensils made of aluminum. In view of the fact that these pamphlets were false, misleading and disparaging they could hardly be regarded as innocent instrumentalities. Yet the court denied the power of the Commission to restrain the publication and sale of these pamphlets on the theory that the publishing company was not using an unfair method or act or practice. The court did not regard it as important that the pamphlets were used by competitors of sellers of aluminum utensils and that the use of the pamphlets provided an unfair competitive advantage to those exploiting the pamphlet. The Commission could restrain the use of these pamphlets unfairly by merchandisers, but were powerless to prevent the publication and sale of the pamphlet by Scientific Manufacturing Company. This is a correct and forthright stand consistent with the dictates of the Federal Trade Commission Act and is far sounder than the decisions in the *Modernistic Candies* case and the *Brewer* case wherein the courts departed from fundamental principles and recognized power in the Commission to restrain mere contributors to persons using an unfair method or practice. There is nothing in the Federal Trade Commission Act which speaks of aiding or abetting or contributing to unfair methods or practices. While superficially this contributory unfair practice doctrine would appear to have an appeal to justice, its unsoundness is demonstrated by the facts in the *Scientific Manufacturing Company* case. Certainly, Scientific Manufacturing Company was aiding and abetting an unfair practice within the meaning of the Federal Trade Commission Act. But the application of that doctrine to the facts in that case appeared so outrageous to the court that it repudiated the existence of that doctrine. This repudiation was required by the clear language of the

Federal Trade Commission Act. Implicit in that act is the concept of user.

In the case at bar the furnishings of the push cards and punch boards to persons who use them in connection with merchandising is no different from the supplying of pamphlets to be used by persons in merchandising kitchen utensils.

The Commission invokes the rule of *particeps criminis* as applicable in a situation where a contributor to an unfair method or practice is sought to be restrained. However, the Commission has been sorely put to square this doctrine with the decision in the *Scientific* case. They labor mightily on Pages 37 to 40 of the *Bork* brief to distinguish the *Scientific* case from the case at bar with respect to the application of the doctrine of *particeps criminis*. The supposed distinction completely escapes us.

The inescapable fact is that in both the *Scientific* case and in the case at bar, the respondents are engaged in the manufacture and sale of items for sale to the public generally. A portion of the public engaged in the sale of merchandise in interstate commerce in both the *Scientific* case and in the case at bar, make use respectively of the Scientific pamphlets and of our push cards and punch boards under circumstances which violate the Federal Trade Commission Act. The cases are distinguished from each other and if the *Scientific Company* was not subject to restraint on the theory of *particeps criminis*, then neither are we. Furthermore, as we have effectively demonstrated in our proceeding point, as to those of our customers which use our punch boards and push cards for merchandising in intrastate commerce, they are not violating the Federal Trade Commission Act and obviously the doctrine of *particeps criminis* cannot possibly apply.

The Commission in its brief (*Bork* Brief, Pages 11 to 13) seeks to create the impression that a legion of cases support the validity of the Commission's order, support the doctrine that commerce in facilities for conducting local lotteries is within the Commission's jurisdiction, and that powers granted

to the Commission include that of eliminating lottery methods in commerce. Examination of these cases discloses that in all of these cases with the exception of the *Modernistic Candies* and *Brewer* cases, the situations involved restraint of the merchandiser himself who was using a lottery method. The only two cases announcing the theory of violation by contribution are the *Modernistic Candies* case and the *Brewer case.* In the *Modernistic* case, the court stated that the *Keppel* case, which is representative of all of the other cases, was inapplicable to the case of a mere contributor as distinguished from one actually using a lottery method of merchandising. On Page 42 of its *Bork* brief, the Commission affirms our comment on all of the cases cited by the Commission by holding forth only two cases as being squarely in point, namely, the *Modernistic Candies* case and the *Brewer* case. These are in fact the only two cases which cover the situation in the case at bar. We have heretofore fully disected the reasoning of the courts in these two cases to demonstrate the unsoundness of the holding therein and we shall not at this point again burden the court with further criticism of these decisions.

CONCLUSION

Our position in the matter is twofold: We first contend that the entire order of the Commission should be set aside; we alternately contend that at least the order should be modified because in its present form it is too broad.

We respectfully submit that the entire order of the Commission is vulnerable because it is founded upon an unsound doctrine of contributory violation. This doctrine finds no support in the basic act and has been repudiated by a soundly reasoned opinion in the *Scientific* case. The entire order should be set aside for this reason.

Alternately, we submit that even if the doctrine of contributory violation were applicable, the order is still too broad because it prohibits shipment of instrumentalities to persons who will not be violating the Federal Trade Commission Act

by using them. Those persons are engaged in intrastate commerce and according to the decision in the *Bunte Brothers* case and the *California Rice Industry* case, they are not within the interdiction of the Federal Trade Commission Act.

In order to obviate the foregoing unanswerable objection to excessive scope, the order should in any event be modified to read as follows::

> "* * * do forthwith cease and desist from:
>
> "Selling or distributing in commerce, as 'commerce' is defined in the Federal Trade Commission Act, punch boards push cards, or other lottery devices to persons, firms and corporations who will pack and assemble assortments comprised of various articles of merchandise together with said push cards and punch board devices for shipment of said assortments in interstate commerce."

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